NO. 402

IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

J. I. CASE COMPANY, HARRY G. BARR, JOHN T. BROWN, L. R. CLAUSEN, WM. J. GREDE, E. P. HAMILTON, WM. B. PETERS, and MARC B. ROJTMAN,

Petitioners,

vs.

CARL H. BORAK, for and on behalf of himself and all of the other common stockholders of J. I. Case Company who are similarly situated to him,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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BRIEF FOR THE PETITIONERS,

Harry G. Barr, John T. Brown, L. R. Clausen, Wm. J. Grede, E. P. Hamilton, Wm. B. Peters and Marc P. Rojtman

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UNITED STATES LAW PRINTING CO., CHICAGO 18, ILL. LA-review 5-6581

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OPINIONS BELOW

The opinion of the District Court for the Eastern District of Wisconsin, while not officially reported, is printed commencing at p. 200 of the printed Record. The opinion of the Court of Appeals for the Seventh Circuit is reported at 317 F.(2d) 838.

JURISDICTION

The judgment of the Court of Appeals for the Seventh Circuit was made and entered on May 29, 1963. The petition for a writ of certiorari was filed on August 26, 1963, and granted on November 12, 1963 ..... U.S. ....., 84 S.Ct. 195. The jurisdiction of this Court rests upon 28 U.S.C. §1254(1).

STATUTES, RULES, AND REGULATIONS INVOLVED

The pertinent portions of the Securities Exchange Act, 15 U.S.C. §78a, *et seq.*, and Rules 14A-3 and 9, 17 CFR 240.14a-3 and 240.14a-9 are set forth in the Appendix to the Petition for a Writ of Certiorari at pp. 36-40.

QUESTIONS PRESENTED

Section 27 of the Securities Exchange Act of 1934 (hereinafter the "Act") provides that the United States District Courts "shall have exclusive jurisdiction of . . . all suits in equity and actions at law brought to enforce any liability or duty created by this title or the rules and regulations thereunder."

The question presented is whether Count II of the Third Amended and Supplemental Complaint (hereinafter the "Complaint") charges facts which constitute a violation

of the Act entitling the plaintiff to maintain a private suit. If so, then is the nature of that suit such that the respondent in his private action may be entitled to retrospective relief by way of rescission or damages by reason of a corporate merger consummated seven years ago. If so, then is the substantive law fixing the liability for rescission or damages uniquely found in the federal Act or the law of Wisconsin.

Ultimately the individual petitioners herein ask whether a Wisconsin corporation and the directors thereof can be denied their statutory right to have a plaintiff stockholder post security for their expenses in defending an action (a) brought to enforce pre-emptive rights created by Wisconsin law which were extinguished in a merger effected through the alleged breach of the directors' fiduciary duties and by using a proxy statement alleged to fall short of the standard required by Sec. 14(a) of the Securities Exchange Act; and (b) seeking to declare proxies void, the merger void, and damages for the violation of the Act?

STATEMENT

The corporate-petitioner has filed an extensive brief in this matter, printer's proof of which these individual petitioners have reviewed. The individual petitioners do, however, file this brief for the purpose of clarifying certain propositions which they deem of particular importance to them. The brief attempts to limit repetitive material except where necessary to provide continuity.

This case reaches this Court seven years after its commencement with a complaint which has been clipped, patched and pasted to evade the consistent direction of the trial court to post security for expenses pursuant to § 180.405, Wis. Stats., 1955, or be dismissed. All motions to repair this prolix complaint have been left undecided by the trial court as moot in view of its direction to post security.

While the allegations of the complaint must be regarded in a general manner in order to categorize respondent's claim, it must also be noted that no irrelevant material has been stricken from this prolix complaint; no answer has been made; no motion has been made to date to rule before trial pursuant to Federal Rule of Civil Procedure No. 12(d) on the affirmative defenses to be raised in the an-

swer[1]; no proof of the allegations has been submitted; no defense and justification of this beneficial merger has been presented.

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[1] For example, nowhere in thirty pages of allegations does respondent allege that any securities of J. I. Case Company are registered on a national exchange so as to make § 14(a) of the Act applicable. This alone is ground for dismissal. *Geismar* v. *Bond & Goodwin, Inc.*, 40 F.Supp. 876 (SDNY, 1941).

Serious questions as to the validity of extra-territorial service of process in 1958 upon Messrs. Elliott, Kraus, Ewing, Sturgis and Choate under the claim of 28 U.S.C. § 1655 being applicable to the Amended and Supplemental Complaint filed April 1, 1958.

ARGUMENT

Insofar as the individual petitioners are concerned, the basic question for determination is whether a stockholder, claiming to seek the voidance of proxies, the voidance of a consummated corporate merger, and damages (from unspecified parties for unspecified injuries) for an alleged violation of § 14(a) of the Act, is stating a unique federal cause of action to which the state security expense statute is inapplicable.

Wisconsin has a security for expense statute, §180.405(4), Wis. Stats., 1955, not unlike that considered and discussed in *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U.S. 541, 69 S.Ct. 1221 (1949). This substantial right to security applies to derivative actions brought in the right of the corporation. The Court of Appeals below on the authority of *McClure* v. *Borne Chemical Co.*, 292 F.(2d) 824 (CA 3, 1961), *cert. den.*, 368 U.S. 939, 82 S.Ct. 382 (1961), held that this substantial right will not be appended to a cause of action based on alleged violations of § 14(a) as such cause is uniquely created by federal law.

1. Does Count II of the Complaint State a Cause of Action to Enforce a Duty or Liability Created by the Act?

The startling anomaly in this case is that the Court of Appeals for the Seventh Circuit determined that because of mere allegations of violations of § 14(a) of the Act, this action is one brought to enforce a duty or liability created by the Securities Exchange Act.

Such determination belies the respondent's own declarations of record[2] and the pleading construed. Count II (Par. 2) recites by adoption:

> "6. Under the common law of Wisconsin shareholders of Wisconsin corporations have preemptive rights . . .
>
> "7. Plaintiff brings this action to enforce the preemptive rights . . ."

This is the basis of respondent's claim. The language is neither equivocal nor ambiguous, and refutes completely any suggestion that the gravamen of the action is to enforce a liability or duty created by the Act or the rules and regulations promulgated thereunder. Like the plaintiff in *Howard* v. *Furst*, 238 F.(2d) 790, 793 (CA 2, 1956), *cert.den.*, 353 U.S. 937, 77 S.Ct. 814 (1957):

> "... (appellants) claim is for violation of state created rights, in no real or substantial sense dependent upon the provisions of the Securities Exchange Act of 1934 relative to proxy statements."

In view of respondent's representations to the trial court and the asseverations placed in his complaint, allegations as to violations of §14(a) of the Act are not basic, but are collateral to his case. Accordingly, the cause of action does not have either its source or its operative limits in the provisions of the federal statute. *Gully* v. *First National Bank of Meridian*, 299 U.S. 109, 57 S. Ct. 96 (1936).

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[2] Permission to file the Third Amended and Supplemental Complaint was granted to respondent on his representation that he desired to file such complaint to seek relief only for violation of preemptive rights. (Unprinted Record, f. 593).

2. A Private Cause of Action for Rescission or Other Retrospective Relief is Not Created By Section 14(a) of the Act.

Federal causes of action under the Act have been created by implication in numerous cases where buyers and sellers of securities are involved. See, Anno., 37 ALR (2d) 649, 650-652. The cause of action has been created by implication under either of two theories: the tort liability theory of §286, Restatement of Torts; or the statutory construction theory. It has been pointed out that either rationalization requires an appraisal of manifest legislative intent. Ruder, *Civil Liability Under Rule* 10b-5, 57 Nw.L.R., 627, 631-635 (1963). No discoverable legislative intent conclusively justifies or refutes the creation of causes of action by implication under the Act. Note, *Implied Liability Under the Securities Exchange Act*, 61 Harv.L.Rev. 859 (1948).

Whatever justifications there might be for holding there is a federally created right of private action under §10(b) of the Act, they are not transferable to justify the creation of a right of private action under §14(a). See, *Brouk* v. *Managed Funds, Inc.*, 286 F.(2d) 90 (C.A. 8th, 1961), *cert. granted*, 366 U.S. 958, 81A S.Ct. 1921 (1961). In *Lapchak* v. *Barium Steel Corp., et al.*, Civil No. 91, 356 (S.D.N.Y., 1955), CCH Fed.Sec.L.Rep., Par. 90, 721, and *Howard* v. *Furst, supra*, the courts found upon irrefutably logical grounds that complaints involving alleged violations of § 14(a) of the Act did not state unique federal causes of action. Accordingly, state law was held applicable and determinative of the limits of the litigation. These holdings appear to be consistent with this Court's

observations in the recent decision of *S.E.C.* v. *Capital Gains Research Bureau*, ... U.S. ....., 84 S.Ct. 275 (1963). There this Court was careful to note that although the federal securities acts included both general and specific proscriptions against nondisclosure, the essence of the law to be applied in such cases is the non-static, vital and ever-changing common law.

In *Dann* v. *Studebaker-Packard Corp.*, 288 F.(2d) 201 (CA 6, 1961), the plaintiff sought a finding that proxies solicited in violation of § 14(a) were void and for rescission of a consummated corporate contract. Unable to substantially distinguish *Howard*, the Court of Appeals for the Sixth Circuit found the action to be not derivative and claimed it would emphasize the right violated as opposed to the damage inflicted. By so doing, the Court was then able to say that the individual right was limited to declaratory judgment, and since the large area of retrospective relief (rescission) which the plaintiff sought was so obviously completely determinable and remediable under non-federally based common law, jurisdiction would be declined upon the basis of *Gully* v. *First National Bank*, *supra*.

The Court of Appeals below held that *Dann* was wrong and *Howard* was more wrong. It is respectfully submitted that neither are wrong. *Howard* holds that a derivative action alleging a violation of § 14(a) states only a common law action under applicable law. *Dann* holds that a non-derivative action claiming an alleged violation of § 14(a) entitles the plaintiff to only a vindication of federal rights; that if plaintiff seeks broad retrospective relief, this is available under state common law in a proper derivative action.

If it is said that the gravamen of Respondent's claim here is to void the merger, that claim does not rely on, nor is it founded in, federal law. Respondent must admit, as plaintiff did in *Lapchak*, *supra*, that a deficient proxy statement followed by a beneficial merger gives rise to no cause of action, but a lawful proxy statement followed by a fraudulent merger is actionable. In short, the violation of § 14(a) has no crucial bearing on the main thrust of the claim. Other than the purely academic question of whether expert proxy statement writers can follow the rules and regulations of the Commission, the only important question in a case of this kind is whether fraudulent acts so substantially taint the effectuation of the merger that it must be rescinded. This question is always answerable without reference to the caliber of the proxy statement. The corporation or a stockholder suing in its behalf derivatively in a proper action can attempt a rescission of the merger. But a rescission for fraud is a time-honored action at common law. References to violations of the Act are "mere excrescence or superfluity, tacked onto what are otherwise sufficient allegations of a claim for relief under . . . (Wisconsin) . . . law." *Howard* v. *Furst*, *supra*, at p. 794.

On the other hand, if respondent's main claim is to have the rights of full disclosure given him by federal law vindicated, he may be entitled to a declaratory judgment as to the validity of the proxies if this Court is willing to say that a proxy is a "contract made . . . the performance of which involves the violation of . . ." the Act or the rules and regulations thereunder. § 29(b), Act. Such an action would arise under the law of the United States and

pursuant to Federal Rule of Civil Procedure 54(c) relief could be given as in *Dann*.[3]

Admittedly such relief may be unappetizing and unrewarding. However, if a respondent seeks more, nothing but his own lack of temerity can hold him back. In order to recover damages or other retrospective relief which may provide a basis for an award of substantial attorneys' fees, respondent can face up to the magnitude of the mischief he creates, avow his claim to be derivative "in the right of his corporation," claim the corporation is entitled to rescind a contract or be reimbursed for alleged frauds of substance committed by the directors and officers, and post security for expenses if required by law. No defendant should escape the court's scrutiny of his actions by procedural hurdles, but by the same token no plaintiff such as the respondent here should be permitted to voluntarily and without the solicitation of others assume the role of guardian of thousands of stockholders[4] and not be prepared to make whole his fellow stockholders if he is wrong and acting contrary to their expressed mandate. This, in the case *sub judice*, respondent is apparently unwilling to do.

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[3] We emphatically urge, however, that the merger between the two corporations cannot be voided under § 29(b) of the Act, because that contract of merger (R. 61-68) was neither made nor performed pursuant to any provision of the Act or any rule or regulation thereunder. That plan of merger was drawn up and adopted solely with reference to the laws of Wisconsin and New York. The only contact the merger had with the Act was purely collateral: the Act prescribes a methodology for absentee voting which is to be used if stockholders in sufficient numbers do not personally attend the meeting.

[4] See, *Cohen* v. *Beneficial Industrial Loan Corp.*, *supra*, p. 549; 1227.

3. The Petitioners Should Not Be Denied Their Statutory Right to Security for Expenses Under Count II of the Complaint.

Respondent, perhaps by design, perhaps by inadvertence, has pleaded a cause of action in Count II which purports to be for the vindication of preemptive rights created by Wisconsin law, for breach of fiduciary duties by the individual petitioners and for violations of the federal act by the corporation and some of its directors. Unless he is willing to plant his foot squarely on a theory and disclaim his intent to go to trial on others,[5] all petitioners will be put to serious disadvantage at trial. By pleading in this multi-cause vein, any theory, including a derivative theory, can be pressed upon the trial court. Should the individual petitioners be vindicated, as they are confident they will be, they will have been put to great expense for which they have a right of indemnity against the corporation. §180.407, Wis. Stats., 1955. The corporate-petitioner on the other hand, may have little likelihood of recovering its full expense and indemnity without the reasonable security required by Wisconsin law.

CONCLUSION.

It is respectfully urged that the holding of the Court of Appeals for the Seventh Circuit that Count II of the Complaint sets forth a uniquely created federal cause of action to which the Wisconsin security for expenses statute is inapplicable, be reversed.

The gravamen of Count II of the Complaint is not uniquely based or dependent upon federal law, and retro-

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[5] See, *McClure* v. *Borne Chemical Co., supra*, on use of disclaimers to avoid application of state security for expense statute.

spective relief may, upon proof of the allegations and equitable jurisdiction, be granted without reference to the alleged violations of § 14(a) of the Act.

No overriding public policy question appears to be involved in this case. The Securities & Exchange Commission has an arsenal of methods to police proxy solicitations including injunction to halt corporate action. Stockholders feeling aggrieved by corporate transactions have statutory appraisal remedies available under state law. Should a stockholder not desire to terminate his investment in the corporation after a transaction is consummated which he feels is illegal, he can bring a derivative action under the law of all states to recoup for the corporation what he believes to have been unlawfully given away and thereby make his investment whole.

For the foregoing reasons, it is respectfully urged that this Court reverse the judgment of the Court of Appeals for the Seventh Circuit insofar as the same reversed the District Court's dismissal of Count II of the Complaint for failure to comply with its prior order fixing security.

Respectfully submitted,

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